

BEFORE THE STATE TAX APPEAL BOARD
OF THE STATE OF MONTANA

KYNAN SPETHMAN,)	
)	DOCKET NO.: IT-2001-3
Appellant,)	
)	
-vs-)	FACTUAL BACKGROUND,
)	CONCLUSIONS OF LAW,
THE DEPARTMENT OF REVENUE)	ORDER and OPPORTUNITY
OF THE STATE OF MONTANA,)	<u>FOR JUDICIAL REVIEW</u>
)	
Respondent.)	

The above-entitled appeal was heard on August 5, 2002, in the City of Missoula, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was duly given as required by law.

The Appellant, Kynan Spethman, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by Tax Program Specialist Jim McKeon, presented testimony in opposition to the appeal. Testimony was presented and exhibits were received.

Mr. Spethman is the appellant in this proceeding and, therefore, has the burden of proof. Based on the evidence and testimony, the Board finds that the decision of the Department of Revenue shall be affirmed.

STATEMENT OF THE ISSUE

The Appellant argues that he timely filed Montana individual income tax returns with the Department for tax years 1998 and 1999, reporting the same adjusted gross income to the Department as he reported on his federal income tax return, thereby meeting his filing requirement with the Department for the years under review.

The Department's position is that the Appellant failed to properly report his "gross income" on the tax returns he filed for tax years 1998 and 1999.

FACTUAL BACKGROUND

1. Due, proper and sufficient notice was given of this matter, the hearing hereon, and of the time and place of the hearing. All parties were afforded opportunity to present evidence, oral and documentary.

2. The Appellant currently resides in Missoula, Montana. For the tax years in question, Mr. Spethman filed tax returns with the Department of Revenue (DOR) indicating that he had been a full-year resident of Montana.

3. Mr. Spethman acknowledges that he was employed and received payment for such employment during the tax years in question.

4. During the tax years in question, Mr. Spethman was employed by Stimson Lumber Company of Bonner, Montana.

Stimson Lumber Company issued Form W-2 (Wage and Tax Statement) to the DOR and to Mr. Spethman, reporting wages paid to the Appellant of \$26,686.63 in 1998 and \$28,676.72 in 1999. Form W-2 also reported that \$843.51 of Montana income tax had been withheld from the Appellant's wages in 1998 and that \$944.32 was withheld in 1999.

5. Mr. Spethman timely filed his 1999 Montana individual income tax return with the DOR. Attached to the return was a W-2 form issued by Stimson Lumber Company, reporting that the Appellant had received wages totaling \$28,676.72 in 1999. On his tax return, Mr. Spethman indicated that he had received \$0.00 in wages, and also reported a federal and state gross income of \$0.00. He requested a refund of \$944.32, the amount of Montana income tax withheld from his earnings in 1999.

6. The Appellant's 1999 return came to the auditing function's attention during the course of routine examination. On May 18, 2000, the DOR adjusted the Appellant's 1999 return to include the wages from Stimson Lumber in the computation of his 1999 taxable income.

7. In a June 17, 2000 letter to the DOR, Mr. Spethman questioned the DOR's authority to revise his return and requested a copy of the Montana Code authorizing such action. Additionally, he requested the DOR assessment

documents relating to the issue and the signature of the person who made the assessment.

8. In a letter dated July 17, 2000, Denise Beckstrom, the originating auditor, responded to Mr. Spethman's June 17 letter. She provided references to Sections 15-30-102 and 15-30-145, MCA. Section 15-30-102, MCA, provides that all income, except that expressly exempted, shall be included and considered in determining the net income of taxpayers. Section 15-30-145, MCA, provides authority for the DOR to revise any return of a taxpayer which it finds to be incorrect. Ms. Beckstrom also stated that she had reviewed the subject 1998 and 1999 tax returns and had concluded that Mr. Spethman had not correctly calculated his tax liabilities. Ms. Backstrom calculated a 1998 tax due of \$1,292.97 and a 1999 tax due of \$359.58.

9. Mr. Spethman responded to Ms. Backstrom by letter dated August 16, 2000, referencing Section 15-30-111, MCA, which contains the definition of adjusted gross income. Mr. Spethman asserted that he claimed the same gross income on both his federal and his Montana return, in accordance with his understanding of the above statute. He also took issue with the fact that the DOR's July 17, 2000 was unsigned because "in matters like these someone needs to sign their

names to their letters, otherwise they are bootleg documents that anyone could make up."

10. DOR representative Denise Backstrom responded by letter dated September 7, 2000. She cited Internal Revenue Service Code 61 and its definition of gross income. She emphasized that this general definition clearly states compensation for services performed is considered gross income. The 1998 and 1999 W-2 statements from Stimson Lumber Company indicate that wages were paid to Mr. Spethman during those years and that those amounts should have been entered on the wage line, line 6, of his Montana tax returns as income. She also informed Mr. Spethman of his appeal rights.

11. Mr. Spethman responded on October 24, 2000. The essence of this letter was Spethman's assertion that he had not received taxable income and that he had abided by the letter of the law in reporting identical amounts of income (zero) on both his federal and Montana returns.

12. On November 3, 2000, Ms. Backstrom sent Mr. Spethman another notice of tax due for 1998 (\$1,324.47) and 1999 (\$374.86).

13. Correspondence ensued between the DOR and Mr. Spethman. Mr. Spethman continued to request DOR assessment documents, policies, procedures and rules pertaining to this

issue. The DOR continued to assert that it had complied with his request for information and that his wages from Stimson Lumber constitute taxable income.

14. On May 7, 2001, Mr. Spethman filed a Request for Informal Review, Form AB-26, with the DOR, stating "Department of Revenue is incorrect in their position."

15. Only July 5, 201, the DOR's Office of Dispute Resolution received the Appellant's file for the purpose of scheduling and conducting a hearing on the matter.

16. An initial conference was conducted on August 3, 2001 by Howard Heffelfinger, DOR hearing examiner. A hearing date of September 18, 2001 was established. Mr. Heffelfinger directed the DOR to provide Mr. Spethman with a copy of the assessment of tax liability no later than August 13, 2001. The DOR's Statement of Adjusted Income Tax Liability was mailed to Mr. Spethman on August 17, 2001.

17. The Appellant requested, and was granted, a postponement of hearing until September 24, 2001.

18. The DOR hearing examiner, David Olsen, issued his Findings of Fact, Conclusions of Law, Opinion, and Order on September 27, 2001. He found the DOR's assessment to be correct.

19. Mr. Spethman appealed that decision to this Board on October 26, 2001, stating: " . . . I believe I have

valid grounds for an appeal and relief from the state. I believe the state did not act with-in (sic) the bounds of the law and wish to appeal there (sic) decision. . ."

20. A hearing before this Board was held on August 5, 2002 in Missoula, Montana.

TAXPAYER'S CONTENTIONS

The thrust of Mr. Spethman's argument in this matter lies in his interpretation of Section 15-30-111, MCA, which defines adjusted gross income for Montana individual income tax purposes as "the taxpayer's federal income tax adjusted gross income as defined in Section 62 of the Internal Revenue Code of 1954. . ." and Section 15-30-101, MCA, defining gross income as "the taxpayer's gross income for federal income tax purposes as defined in Section 61 of the Internal Revenue Code. . ." Mr. Spethman's interpretation of these statutes is that an individual's Montana tax liability is exactly the same as the federal tax liability. Since he recorded zero dollars in income on his federal return for tax years 1998 and 1999, he recorded zero dollars on his Montana returns for those years as well.

Additionally, his understanding of the instructions accompanying the income tax return form ("for line 19, enter the amount on line 23 of your federal 1040 . . ., lines 6-18, enter all items of income you reported on your federal

income tax return . . . " led him to the conclusion that the amount of income reported on the federal and state returns be identical.

Mr. Spethman did not provide an explanation as to why he entered zero dollars as income on his federal and state returns when his W-2 statements from Stimson Lumber Company indicated that he did receive wages in 1998 and 1999.

He also took issue with the DOR's repeated failure to provide him with a signed assessment.

DOR'S CONTENTIONS

The DOR's position regarding the charge that it continually failed to provide Mr. Spethman with a signed assessment is that this is a secondary issue. The critical issue is what constitutes gross income and what is taxable to Montana.

DOR Exhibit 1 contains a five-page document dated August 17, 2001 which outlines the subject assessment. Mr. McKeon defines an assessment as "a notice of change in the return. . . a statement of account is a notice of assessment. A statement of account was sent to Mr. Spethman, notifying him that a change was made on his tax return as authorized by law." (State Tax Appeal Board hearing, August 5, 2002).

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He testified that the DOR does have the authority, provided in Section 15-30-145, MCA, to adjust a return upon discovery of discrepancies, errors or omissions.

Mr. McKeon stated that Mr. Spethman did receive an assessment as a result of the filing of his 1999 Montana individual income tax return. Upon receipt of the 1999 return, Mr. Spethman's return was entered into the DOR's data entry system and was subjected to a mathematical calculation. An error resolution sheet was generated due to the fact that Mr. Spethman did not report any gross income. The error resolution sheet was manually reviewed by an auditor, Denise Backstrom. Ms. Backstrom adjusted the return and notice was given to Mr. Spethman of the change.

The amount due and owing is \$1,404.81 for tax year 1998 and \$399.84 for tax year 1999 (DOR Exhibit A).

DOR Exhibit A contains a copy of Mr. Spethman's 1997 Montana Individual Income Tax return. For that tax year, Mr. Spethman did report his gross income and earned wages and paid tax on it. In 1997, Mr. Spethman reported a wage corresponding to that reported by Stimson Lumber Company on its W-2 form provided to the DOR (\$12,164.56).

For the tax years in question, Mr. McKeon pointed out that it is erroneous to entertain the belief that the

definition of adjusted gross income, found in Section 15-30-111, MCA, is what is reported on the federal return. Rather, that statute provides that adjusted gross income is the taxpayer's federal income tax adjusted gross income as defined in Section 61 of the Internal Revenue Code (IRC). Section 61 of the IRC defines gross income as, among other things, compensation for services performed. Mr. Spethman's income is compensation for services performed and a W-2 was issued by his employer stating the amount of compensation he received. This income is what should be reported on line 6 of the Montana individual income tax return.

According to his 1998 W-2 form, Mr. Spethman earned \$26,686.63. Mr. Spethman did meet the income thresholds required by Section 15-30-142, MCA, which requires a taxpayer to file a Montana return if he or she meets the filing requirements. The DOR's position is that the \$26,686.63 reported by Stimson Lumber Company as wages paid to Mr. Spethman is gross income, not what was reported on his federal return. Similarly, for 1999, Mr. Spethman reported zero dollars on line six of his Montana return (wages, salaries, tips, etc.). His 1999 W-2 form reported \$28,676.72.

The DOR adjusted both the 1998 and 1999 returns to reflect the proper amount of gross income, allowing Mr.

Spethman one exemption for a single individual and the standard deduction to arrive at a corrected tax liability for those years.

Mr. McKeon requested that tax year 2000 be included in the present proceedings as Mr. Spethman's return for that tax year is also out of compliance. Upon Mr. Spethman's objection to the inclusion of tax year 2000 in the present case, the Board denied the request.

BOARD'S DISCUSSION

The Board finds merit in the DOR's position that the proper gross income to be reported on a Montana individual tax return is not simply the amount reported on the federal return. Clearly, the gross income to be reported on a Montana return is that income which is defined in Section 15-30-101 (7), MCA, and 26 U.S.C. 61. There is no question that Mr. Spethman's wages, reported to him and to the taxing authorities by his employer via the W-2 forms, constitute taxable compensation for services performed.

Regarding Mr. Spethman's contention that the DOR repeatedly failed to provide him with a signed assessment, the Board finds it unfortunate that the DOR waited so long to provide him with the August 17, 2001 Statement of Adjusted Tax Liability which outlined the adjustments made to the W-2 income to arrive at the corrected tax liability

at issue here. If this document had been placed in Mr. Spethman's hands early in the proceedings, it might have gone a long way towards easing his frustration with the entire process. However, the Board finds that Mr. Spethman did receive a complete and accurate description of the basis for the additional tax liability and that his appeal options were not compromised.

CONCLUSIONS OF LAW

1. §15-2-302, MCA. Direct appeal from department decision to state tax appeal board - hearing. (2)(a) Except as provided in subsection (2)(b), the appeal is made by filing a complaint with the board within 30 days following receipt of notice of the department's final decision.

2. §15-30-101 (7), MCA. "Gross income" means the taxpayer's gross income for federal income tax purposes as defined in section 61 of the Internal Revenue Code of 1954 (26 U.S.C. 61) or as that section may be labeled or amended.."

3. §15-30-102, MCA. Construction of net income. . . The net income required to be shown on returns under this chapter and taken as the basis for determining the tax hereunder . . .includes all income except what has been expressly exempted under the constitution of this state or the constitution or laws of the United States shall be

included and considered in determining the net income of taxpayers with the provision of this chapter. (Emphasis supplied.)

4. U.S.C. § 61. Gross income means all income from whatever sources derived, including, but not limited to, compensation for services . . . (emphasis supplied).

5. §15-30-145 (1), MCA. Revision of return by department - statute of limitations - examination of records and persons. If, in the opinion of the department, any return of a taxpayer is in any essential respect incorrect, it may revise the return.

6. The appeal of the taxpayer is hereby denied and the decision of the Department of Revenue is affirmed.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board
of the State of Montana that the subject assessment is
properly due and owing.

Dated this 19th day of August, 2002.

BY ORDER OF THE
STATE TAX APPEAL BOARD

(S E A L)

GREGORY A. THORNQUIST, Chairman

JERE ANN NELSON, Member

MICHAEL J. MULRONEY, Member

NOTICE: You are entitled to judicial review of this Order
in accordance with Section 15-2-303(2), MCA. Judicial
review may be obtained by filing a petition in district
court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 19th day of August, 2002, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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